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UNITED STATES GENERAL ACCOUNTING OFFICE

REGIONAL OFFICE

502 U S CUSTOMHOUSE 2D AND CHESTNUT STREETS

PHILADELPHIA, PENNSYLVANIA 19106

June 29, 1971

Commanding Officer
Naval Ship Systems Command
Arlington, Virginia 22202

Dear Sir:

We have reviewed the pricing of 32 steam turbine generator sets (1000KW) purchased from De Laval Turbine, Inc., Trenton, New Jersey, under contract N00024-69-C-5254 awarded by the Naval Ship Systems Command on December 11, 1968. Negotiations resulted in a firm fixed-price contract of \$8,993,360 which was definitized on April 11, 1969. Our review was primarily concerned with the reasonableness of the price negotiated in relation to cost or pricing information available to the contractor at the time of negotiation and the adequacy of Government technical and audit evaluations of the contractor's cost proposal.

Our review showed that the negotiated price was \$201,257 higher than justified by cost or pricing data available prior to negotiation. Of this amount \$131,408 resulted because the provision for setup labor was higher than warranted by experience under a preceding contract. The balance of \$69,849 is attributed to the failure of the contractor to adjust prior cost experience for a change in a testing procedure.

The overpricing amount is detailed in the following tabulation:

	<u>Excessive setup charges</u>	<u>Change in test procedure</u>	<u>Total</u>
Direct labor	\$ 19,980	\$10,620	\$ 30,600
Manufacturing overhead	<u>79,279</u>	<u>42,140</u>	<u>121,419</u>
Subtotal	\$ 99,259	\$52,760	\$152,019
General and administrative expense	<u>16,934</u>	<u>9,001</u>	<u>25,935</u>
Subtotal	\$116,193	\$61,761	\$177,954
Profit	<u>15,215</u>	<u>8,088</u>	<u>23,303</u>
Overpricing	<u>\$131,408</u>	<u>\$69,849</u>	<u>\$201,257</u>

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In addition to the above, we believe that a further price reduction of about \$126,000 could have been obtained during negotiations had the Government negotiator made appropriate use of the Defense Contract Audit Agency (DCAA) findings. (See p. 4 .)

Contract -5254 includes a defective pricing data clause that provides for decreasing the contract price if the Government determines that the price was significantly increased because cost or pricing information submitted by De Laval was not accurate, complete, or current. De Laval was requested to submit cost and pricing information on two bases--one for a single-year procurement and the other for a multiyear procurement. Subsequent negotiations were based on the cost and pricing data for the multiyear procurement. De Laval certified to the accuracy, completeness, and currency of the cost and pricing information submitted.

Our findings with regard to the overpricings are set forth below.

EXCESSIVE PROVISION FOR SETUP LABOR

De Laval's proposal included 14,779 labor hours to set up machinery and equipment to manufacture the bits and pieces for the turbine generator sets. De Laval proposed to manufacture the bits and pieces in lots, corresponding generally to the periodic requirements of the contract.

The proposed setup hours were based on experience under a prior contract. The setup hours under that contract for the nine turbines produced as one lot were reduced to a unit basis, doubled, and then multiplied by the number of units to be produced to determine the setup hours for the first two lots on contract -5254. The total setup hours for the first year requirements, reduced by 40 percent, was then used for each of the remaining three lots. The reduction of 40 percent appears to have been an attempt by De Laval to equate the first year requirement with the lesser number of turbines bought for each of the remaining 3 years. In view of the fact that the setup time for each lot is unaffected by the number of units in the lot, that is setup time is essentially constant, we inquired into the basis for such an estimating technique. De Laval could provide no explanation for its calculations or why the inappropriate use of setup data had escaped its review process.

Using the same experience data on which De Laval based its proposal, but applying it on a lot basis, we computed 9,135 hours for the setup category of direct labor. De Laval's computation was 5,644 hours higher. By using the negotiated labor rate, we calculated this overpricing as \$19,980 (exclusive of manufacturing overhead, general and administrative expense, and profit). De Laval agreed with the reasonableness of our computations.

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A Defense Contract Administration Services (DCAS) technical analyst evaluated De Laval's proposed labor hours. According to his report, the emphasis of his review was directed to the single-year procurement proposal (in effect the first two lots to be manufactured) since supporting data for both the single-year and multiyear procurements were developed using identical facts. Had the technical analyst evaluated the multi-year aspects of the proposal, he would have, in our opinion, noted that setup hours for the multiyear quantities were disproportionately higher than those for the single-year quantity. This would have served as a basis for further inquiry and identification of this point.

CHANGE IN TESTING PROCEDURE
NOT CONSIDERED

For contract -5254, De Laval requested a deviation from the Government's standard testing procedures to permit the testing of each pair of turbine generator sets with the same pair of condensers. The request was approved and a clause was inserted in the contract to provide for this deviation. Thus only the last two condensers shipped would need cleaning. However, De Laval made no corresponding adjustment in its proposed costs for the savings in cleaning costs that could be expected from this change in testing procedures.

The labor hour experience used as the basis for the proposal for contract -5254 included time required to clean each condenser after testing had been completed. We were advised by the De Laval supervisor having cognizance over this operation that it usually takes about 100 hours to clean a condenser after testing.

On the basis that the cleaning operation would be required for only two condensers after testing the last units, we computed the overstatement in the proposal as 3,000 hours (100 hours x 30 units). The resulting excess labor provision in the final negotiated price was \$10,620 (exclusive of manufacturing overhead, general and administrative expense, and profit).

De Laval representatives, in commenting on our finding, stated that:

- The intent of the change was to expedite shipment of the completed turbine generator sets.
- Government approval for the change was in the nature of permission to conduct the tests in the manner requested, if De Laval so desired.
- The multiyear feature of the contract, in effect, results in four annual contracts, on this basis, the two condensers used each year would have to be cleaned because they would be shipped with the completed turbine sets.
- On an after-the-fact basis, De Laval was not always able to ship a new condenser with each turbine because of a strike at its condenser plant.

De Laval's first and second comments above, in our opinion, are not relevant to the issue. On the multiyear point, fund approval for one year is far in advance of delivery of completed units for the prior year and there may be, in effect, continuity of production. The strike at the condenser plant was an unforeseeable event having no bearing on what should have been negotiated. In summary, the cost impact of this change should have been considered during negotiations and the price reduced accordingly. Further, if the Government required the contractor to deviate from the agreed procedure, the cost impact could have been contingently provided for in the basic contract or handled through the changes article of the contract.

The technical analyst, in his report, did not comment on De Laval's proposed labor hours for testing the completed turbine generator sets. The work files relating to this preaward evaluation were not retained. The technical analyst stated that, in view of the absence of these files, he could not comment on the reason that the changes in time requirements for testing were not reported. We can only conclude that the effect on labor hours through use of the same set of condensers was not considered, or the price negotiated for this contract would have been reduced.

INCORRECT APPLICATION OF DCAA
FINDINGS DURING NEGOTIATIONS

As previously stated, De Laval was required to submit its proposal on two bases--for a single-year procurement and a multiyear procurement. DCAA recommended cost disallowances on each of the two bases. The price effect of the findings for the two bases differed. In establishing his price objective, the Government negotiator applied the lesser amount questioned for the single-year procurement (two lots) to the multiyear procurement cost data (five lots) submitted by De Laval. As a result the price accepted by the negotiator for the multiyear procurement was more than the amount DCAA regarded as acceptable by \$3,932 a unit and \$125,824 in total. The negotiator would have been justified in attempting to negotiate a price about \$126,000 lower.

We brought this matter to the attention of personnel in the Naval Ship Systems Command. They had no comments other than they could not understand why this oversight by the negotiator was not disclosed by reviews at higher levels within the Navy.

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We recommend that Navy procurement officials consider the above findings, along with any additional information available, to determine the Government's legal entitlement to a price reduction with respect to contract -5254.

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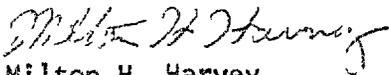
We would appreciate being advised of action taken or to be taken by your agency with regard to the matters discussed in this letter. Copies of this letter are being sent to the following:

Commander, Defense Contract Administration Services Region
Philadelphia, Pennsylvania

Regional Manager, Defense Contract Audit Agency
Philadelphia, Pennsylvania

De Laval Turbine, Inc.
Trenton, New Jersey

Sincerely yours,


Milton H. Harvey
Acting Regional Manager

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